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IF THIS BE SIMPLIFICATION — A VIEW OF PRE-1942 POWERS OF APPOINTMENT AND THE 1954 INTERNAL REVENUE CODE SECTION 2041

*Harrop A. Freeman**

This article is intended to raise a very limited problem under the estate tax provision of the 1954 Internal Revenue Code relating to powers of appointment created before 1942 and to use this as one example of the lack of clarity in policy and operation to be found in the 1954 Code. The provisions here under consideration were introduced by the Power of Appointment Act of 1951, continued as Section 2041 of the 1954 Code, supposedly to clarify the law and eliminate areas of uncertainty.[1] But it is respectfully submitted that here, as in other areas, particularly in peripheral matters, the 1954 Code has raised or continued rather than settled, issues. On its face Section 2041 seems simplicity itself—pre-1942 general powers are taxable if exercised, post-1942 general powers are taxable whether exercised or unexercised. There can be no gainsaying that this is an improvement over the rules in operation between 1942 and 1951.[2]

The issue to which I wish to address myself is the clarity of the law as to whether one who would take in default of appointment has the right to reject an appointment under a pre-1942 power and accept as default taker and whether thereby a second tax on the property in the estate of the donee of the power will or should be avoided.

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* See Contributors' Section, Masthead, p. 535, for biographical data.

I wish to acknowledge with appreciation the assistance of Norman Freeman, Cornell Law '56, on whose research part of this article is based.

1 If tax statutes seek to avoid "shadowy and intricate distinctions of common law property concepts and ancient fictions" [United States v. Jacobs, 306 U.S. 363, 368 (1939)] and "elusive and subtle casuistries, . . . unwitting diversities of the law of property" [Helvering v. Hallock, 309 U.S. 106, 118 (1940)] it is of doubtful wisdom to leave unsettled questions relating to "powers"—one of the most complex areas of law. The Senate Finance Committee Report on the 1951 Powers of Appointment Act states: "Your committee believes that the most important consideration is to make the law simple and definite enough to be understood and applied by the average lawyer, and that the present bill will accomplish that purpose." S. Rep. No. 382, 82d Cong., 1st Sess. 1530, 1531 (1951). See also S. Rep. No. 1622, 83rd Cong., 2d Sess. 1635 (1954).

2 Prior to October 21, 1942 the statute included as a part of gross estate only property passing under the exercise of a general power of appointment. By the 1942 Act, Int. Rev. Code of 1939 § 811(f) was modified to include in the estate, property subject to either a general or special power, exercised or unexercised, except (a) pre-1942 general powers if released prior to a date (extended to July 1, 1951), and (b) special powers if their exercise was limited in favor of a narrow class of relatives, exempt charities, or if the donee had no beneficial interest in the property and held the power as a trustee. Exercise in conjunction with another did not exempt the power and the "special" power exemption was lost if used to create a second power.

THEORY, HISTORY AND POLICY

The legal theory of powers of appointment is that since the owner of property may transfer it and control its use after transfer, he may give to a donee the power to appoint the property on his behalf; the donee of a power has no property right (though it is recognized that the quantum and character of the donee's interest varies widely from the approximation to a trust for special powers to almost absolute ownership in the case of general powers); he acts in an agency relationship and relates his appointment back to the donor of the power; such a transfer, like other transfers, exists because the parties willed or intended it and whether a power passes the property is a question of the intent of the donor and the intent of the donee.[3] Closely related to this approach is another rule, applicable to wills and other devices for transferring property, as well as to powers of appointment, that no person is compelled to accept a devise or other transfer—the transfer is a consensual transaction and consent of the recipient must be shown.[4] This is true (absent fraud or collusion)[5] regardless of motive, including the motive to avoid or reduce taxes.[6] At the same time, there has been an extensive recognition that the general power of appointment approximates ownership.[7]

A little tax history will also be of value. The Revenue Act of 1916 did not refer to powers of appointment in stating the property to be included in an estate but made inclusion depend (Section 202) upon whether prop-

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3 5 American Law of Property §§ 23.1-.8 (Casner ed., 1952) and bibliography there cited, § 23.14; Lord Justice Fry in Ex parte Gilchrist, 17 Q.B.D. 521, 531 (1886); Restatement, Property § 318ff (1936).

4 Whether the theory is one of offer and acceptance, or postponing vesting until acceptance, or renunciation making the gift void from its inception (the three usual theories), the cases and texts are consistent in their holdings. See Helvering v. Grinnell, 294 U.S. 153 (1935); Brown v. Routzahn, 63 F.2d 914 (6th Cir. 1933); Peter v. Peter, 343 Ill. 493, 175 N.E. 846 (1931); Lehr v. Switzer, 213 Iowa 658, 239 N.W. 564 (1931); In re Stone, 132 Iowa 136, 109 N.W. 455 (1906); Strom v. Wood, 100 Kan. 556, 164 Pac. 1100 (1917); Chilcoat v. Reid, 154 Md. 378, 140 Atl. 100 (1928); Bouse v. Hull, 168 Md. 1, 176 Atl. 645 (1935); Albany Hospital v. Albany Guardian Society, 214 N.Y. 435, 108 N.E. 812 (1915); Whigham v. Bannon, 20 Ohio App. 496, 153 N.E. 252 (1936); Ohio Nat. Bank of Columbus v. Miller, 57 N.E.2d 717 (Ohio App. 1943); Tarr v. Robinson, 158 Pa. 60, 27 Atl. 859 (1893); Bradford v. Leake, 124 Tenn. 312, 137 S.W. 96 (1911); Townson v. Tickell, 3 Barn. & Ald. 31, 106 Eng. Rep. 575 (1819); 4 Page, Wills, §§ 1402, 1404 (1941); 7 Heaton Surr. Cts. § 707 (5th ed. 1930); 69 Corp. Jur., Wills §§ 2158, 2168; 57 Am. Jur., Wills, §§ 1566, 1573.

5 Schoonover v. Osborne, 193 Iowa 474, 187 N.E. 20 (1922); Bradford v. Calhoun, 120 Tenn. 53, 109 S.W. 502 (1908).

6 Annot., 60 A.L.R. 312 (1929); 69 Corp. Jur., Wills § 2168; 57 Am. Jur., Wills, § 1566; C.I.R. v. Macauley's Estate, 150 F.2d 847 (2d Cir. 1945), Note Wis. L. Rev. 632 (1938); cf. Cal. Revenue and Taxation Code § 13-409 (Deering 1952).

7 5 American Law of Property §§ 23.4, 23.16-.19 (Casner ed., 1952).

erty was "subject to distribution as part of his estate" and "subject to the payment of the charges against his estate and the expenses of its administration." The donee of a power of appointment, even upon exercise, was not deemed the owner of property subject to estate tax.[8] The 1918 Act included in the estate "property passing under a general power of appointment exercised by the decedent";[9] this was continued till 1942. Under this it was held that for federal tax purposes a general power was one exercisable in favor of the donee, his estate or his creditors,[10] an unexercised general power of appointment was not taxable,[11] a power exercisable only with another person was not a general power[12] and that if the donee attempted to appoint to the same people who would take in default of appointment and in the same shares and those persons renounced under the power, the property was not taxable either because it did not "pass" or because there was no "exercise."[13] Largely spearheaded by Professor Griswold and Tax Adviser to the Secretary of the Treasury, Randolph E. Paul,[14] a movement for revision pushed through the 1942 Revenue Act, Section 405,[15] the previous statute having been found "inadequate" and a "device for the avoidance of estate tax."[16]

Dissatisfaction with the 1942 statute was widely expressed and as a result the effective date of operation of portions of the Act was extended from time to time to July 1, 1951. Committees of the American Bar Association and American Bankers Association were formed and conferred from 1943 to 1950 with the Treasury Department. The chief criticisms were against taxing pre-1942 powers contrary to the law in force for 25 years, the effect of the release provisions to tax the unwary, and the complex and illogical distinctions between taxable and exempt powers. A Treasury-sponsored bill to tax all powers exercisable in favor of per-

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8 United States v. Field, 255 U.S. 257 (1921); Annot., 18 A.L.R. 1470 (1922). This recognized the property rule that the donee is the agent of the donor without property rights.

9 Revenue Act of 1918 § 402(e), 40 Stat. 1097 (1919).

10 Morgan v. Commissioner, 309 U.S. 78 (1940).

11 Helvering v. Safe Deposit & Trust Co., 316 U.S. 56 (1942).

12 Charles J. Hepburn, 37 B.T.A. 459 (1938).

13 Helvering v. Grinnell, 294 U.S. 153 (1935); Rogers Estate v. Commissioner, 320 U.S. 410 (1943).

14 Griswold, "Powers of Appointment and the Federal Estate Tax," 52 Harv. L. Rev. 929 (1939), first viewing a general power existing at death and exercised or unexercised as taxable; cf. Leach, "Powers of Appointment and the Federal Estate Tax—A Dissent," 52 Harv. L. Rev. 961 (1939); cf. McDougal, "Future Interests Restated: Tradition Versus Clarification and Reform," 55 Harv. L. Rev. 1077, 1110 (1942); Statement of Randolph E. Paul, Hearings before House Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d Sess. 91 (1942).

15 56 Stat. 942 (1942).

16 H.R. Rep. No. 2333, 77th Cong., 2d Sess. 160 (1942).

sons outside of a "class not unreasonably large" was defeated. When the American Bar Association could not gain acceptance of its views by the Treasury Department, its bill, H.R. 2084, was introduced and with slight modification became the Powers of Appointment Act of 1951. Therefrom came Section 2041 of the 1954 Code, the pattern of which is to tax no special powers, to tax pre-1942 general powers if exercised and post-1942 powers exercised or unexercised and to define general powers as those exercisable in favor of the donee, his estate, his creditors or the creditors of his estate.[17]

Over the years, the major statements of tax policy with regard to powers of appointment have appeared in our law journals—and very interesting reading these make. In 1939 Erwin Griswold spoke from the view of the taxation professor in favor of freeing taxation from the confining property rules relating to powers. He urged that general powers were the equivalent of ownership by the donee so that they should be taxed whether exercised or unexercised, and that "general power" should have a federal definition which does not fluctuate from state to state and which includes all powers exercisable in favor of the donee, his estate or creditors.[18] He also first made the extended distinction between "passing" and "exercised."[19] Future Interests Professor W. Barton Leach dissented on the ground that powers of appointment, and particularly special powers, gave desirable flexibility in disposition of family funds compared to rigid remainders, that nonexercise of even a general power should not be taxed for it took nothing away from the takers in default, and that Professor Griswold's proposal would not materially increase revenue.[20] Professor Griswold's policy was that adopted in the 1942 Act, Professor Leach's represents the pre-1942 and the 1951 and 1954 rules as to pre-1942 powers. Shortly after this Professor McDougal of Yale proposed a tax, which would affect each generation only once with provisions reach-

[17] The history is reviewed in detail in Buck, Craven and Shackelford, "Treatment of Powers of Appointment for Estate and Gift Tax Purposes," 34 Va. L. Rev. 255 (1948). See also report of the Committee on Taxation of the Association of the Bar of the City of New York (1947); Hearings before Committee on Ways and Means on H.R. 3533, 80th Cong., 1st Sess. (1947); Report, Special Tax Study Committee to the Committee on Ways and Means (Nov. 3, 1947); 97 Cong. Rec. 5121, 5128 (1951); 97 Cong. Rec. 7041 (1951); H.R. Rep. No. 327, 82d Cong., 1st Sess. (1951); S. Rep. No. 382, 82d Cong., 1st Sess. (1951); Minority Report of the Ways and Means Committee on H.R. 2084, H.R. Rep. No. 327, pt. 2, 82d Cong., 1st Sess. (1951); H.R. Rep. No. 2245, 81st Cong., 2d Sess. (1950); Craven, "Powers of Appointment Act of 1951," 65 Harv. L. Rev. 55 (1951).

[18] Griswold, "Powers of Appointment and the Federal Estate Tax," 52 Harv. L. Rev. 929 (1939).

[19] Id. at 933, 944.

[20] Leach, "Powers of Appointment and the Federal Estate Tax—A Dissent," 52 Harv. L. Rev. 961 (1939).

ing powers of appointment.[21] The policy embodied in the 1942 Act was strongly defended by Louis Eisenstein, Senior Attorney, Tax Legislative Counsel's office, Treasury Department.[22] Many other articles of that period took sides in discussing either federal or state taxation of powers.[23] Little was written on the policy considerations until the 1942 Act was considered for revision in 1948 and ultimately changed in 1951. The earlier studies did not appear in our journals,[24] but have been adequately reviewed in later articles.[25]

Generally speaking, those who wanted to abrogate property concepts in taxing powers of appointment were in the stream of modern tax theory and emphasized the necessity for preventing tax evasion or avoidance through the use of powers of appointment which had the effect of permitting choice of devolution at two periods for the price of one tax. The opposition recognized that powers were legitimate legal tools of flexible property disposition and ought not to be discouraged, absent overwhelming proof of tax loss. The present writer must record himself as a middle-of-the-roader. I strongly support the view, adequately expressed by Griswold, Eisenstein and others,[26] that taxation should avoid the intricate distinctions and fictions of common law property concepts *when there is a clear tax reason therefor*. At the same time powers are not merely subjects of taxation, they are social institutions which may be encouraged or damaged by taxation. When the 1948 marital deduction provisions recognized a power of appointment as qualifying for this deduction, powers of the prescribed scope took on new importance; when the 1951 Powers of Appointment Act allowed non-general powers to go tax free, tax planners began extolling the special power.[27] It now becomes fairly clear that little loss or increase of revenue results from the varied tax treatment of powers of appointment and that the motivating concern is simplification.[28] It is precisely because I see no valid *tax reason* why takers in

21 McDougal, "Future Interests Restated: Tradition Versus Clarification and Reform," 55 Harv. L. Rev. 1077, 1110 (1942).

22 Eisenstein, "Powers of Appointment and Estate Taxes," 52 Yale L.J. 296 (1943).

23 Paul, Federal Estate and Gift Taxation c. 9 (1942); Oliver, "Property Rationalism and Tax Pragmatism," 20 Texas L. Rev. 675 (1942); Leach, "Powers of Appointment," 24 A.B.A.J. 807 (1938); Thompson, "State Death Taxes and Powers of Appointment," 26 Iowa L. Rev. 549 (1941); Powell, "Powers of Appointment," 10 Brooklyn L. Rev. 233 (1941); Bordwell, Book Review, 53 Harv. L. Rev. 157 (1939); Angell, "The Impact of the Law of Powers upon Our Internal Revenue Laws," 39 Mich. L. Rev. 1269 (1941).

24 See note 17 supra.

25 See particularly Buck, Craven, and Shackelford, supra note 17, and Craven, "Powers of Appointment Act of 1951," 65 Harv. L. Rev. 55 (1951).

26 See notes 17, 18, and 22 supra.

27 Bowe, Tax Planning for Estates 9-10 (1955); Shattuck and Farr, An Estate Planner's Handbook §§ 24, 41 (1953).

28 H.R. Rep. No. 327, 82d Cong., 1st Sess. 4 (1951); S. Rep. No. 382, 82d Cong., 1st

default should be taxed when they elect to take under the original instrument that this article is written.

What and Why Pre-1942 Powers

Since Section 2041(a)(1) of the 1954 Code taxes "property with respect to which a general power of appointment created on or before October 21, 1942, is exercised," compared to Section 2041(a)(2) which taxes post-1942 powers whether exercised or not, it should be clear, if possible, precisely which are "pre" and which "post" powers. In the case of a presently conferred power it would appear that the power was "created" at the date of the instrument. Suppose, however, an *inter-vivos* instrument executed in 1940 containing a power of appointment to take effect later, e.g., "upon my death" or "upon sale of Blackacre." This power also seems "created" pre-1942 even though the grantor dies or Blackacre is sold in 1954. Yet it is little different in effect from a power embodied in a 1940 executed will, the testator dying in 1954. When then is a power embodied in a will "created"? A power of appointment in a will is "created," in the sense of formulated and adopted as the intent of the decedent, at the date he executes his will (1940) and becomes "effective" upon his death (1954) if the will is not revoked. Yet a will is ambulatory until death and creates no rights prior to that time. Actually in the law of wills there are two sets of rules, one which favors "creation" being the date of execution,[29] the other the date of death.[30] It is reasonably clear from the exception contained in Section 2041(b)(3) that the Code assumes that a power of appointment in a will is "created" at the date of the decedent's death (unless the testator dies before July 1, 1949 and the will was executed before October 21, 1942, in which exception the date of execution governs). This provision was first inserted as a part of the Treasury-sponsored H.R. 3533 of 1947 (a forerunner of many of the provisions of the 1951 Powers of Appointment Act), and apparently re-

Sess. (1951); Buck, Craven, Shackelford, supra note 17 at 259; Craven, supra note 25 at 55-63, 83.

29 On the other hand, (a) it is generally recognized that in construing a will, the intent at the time of execution controls, and the question remains whether the power was intended to be executed in every way except to the same persons in the same shares as would take by default [2 Page Wills § 918 (1941)] (b) the testator is deemed to know the law and to embody in his will the law as it stands [2 Page Wills § 925; Matter of Salmon's Executors, 252 N.Y. 381, 169 N.E. 616 (1930); e.g., presumed to know that a wife could renounce: In re Povey's Estate, 271 Mich. 627, 261 N.W. 98 (1935)] (c) and the law in force at the time of execution controls construction or intention, even if the law changes [2 Page Wills § 939; e.g., if the language used would pass a different estate under change of law: Schiemann v. Bogert, 17 N.J. Misc. 329, 8 A.2d 906 (1939)].

30 On the other hand a will speaks as of death and a power of appointment in the will comes into effect then. 2 Page Wills § 938 (1941).

lated to the period within which a pre-1942 power could be released or partially released so as to constitute an exempt power; little point was made of its purpose.[31] This was carried into the 1951 Act and into the 1954 Code with the comment that it "merely continues in force a provision which was enacted in 1948."[32] In the light of the 25 years pre-1942 history taxing only exercise of powers of appointment, in the light of conflicting theories of wills and the inexactness of the word "created," in the light of no adequate period being given to review wills of perhaps 25 years standing,[33] in the light of serious changes in health or other situations between the execution of wills pre-1942 and death post-1948 rendering revision of the will dangerous,[34] would it not be politic to consider powers in wills executed pre-1942 as pre-1942 powers regardless of the date of death? Surely no method of tax evasion is presented thereby.

A "General" Power

Under Section 2041(a) of the 1954 Code only property with respect to which a *general* power of appointment pre-1942 is exercised and post-1942 exists, is taxed. Section 2041(b) defines a "general power" for this purpose differently from common law property definitions. For tax purposes a general power is one "exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate," except (a) the power to "consume, invade, or appropriate" . . . "limited by an ascertainable standard," (b) a joint power created before October 21, 1942 and (c) a post-1942 joint power if the other donee is the creator of the power or a person having a substantial adverse interest in the property.

Beginning with the Revenue Act of 1942 and again in the 1948 proposal as to powers of appointment, H.R. 3533, the common law terms of "general" and "special" powers were avoided and this was widely commended.[35] This writer also believes it highly desirable to define specifically and in non-technical terms what is to be taxed. But I have to record my view that, far from clarifying the matter, the present statute leaves much uncertainty and inequity. Let me outline a few of these situations.

As is to be expected, lawyers raise the question whether, if they exclude

[31] See H.R. 3533, 80th Cong., 1st Sess. (1947); Buck, Craven and Shackelford, supra, note 17 at 266-8.

[32] S. Rep. No. 382, 82d Cong., 1st Sess. (1951); Craven, supra note 25 at 66. See also U.S. Treas. Reg. 105, § 81.24 (1939).

[33] It is little solace to tell a man he could have died before 1949.

[34] The re-execution of the will may bring it within the rules of contemplation of death or any of the other changes of law post-1942 which were not made retroactive and would not therefore apply.

[35] Randolph Paul, Federal Estate and Gift Taxation § 9.30 (1946 Suppl.).

the "donee, his estate, his creditors, or the creditors of his estate" as potential takers, the power will escape tax. The power will be clearly a "non-defined" power; it probably is not a "special power"; one writer, Allan McCoid, has called it a "non-general power."[36] I do not need to point out, for Allan McCoid has done it so admirably, that there is considerable and conflicting law as to whether such a power is treated as exercisable in favor of the donee or his creditors and whether such power raises serious problems of property law, particularly with reference to the rule against perpetuities. He strongly discourages use of such a power. But it must be remembered that almost from the beginning the Regulations have defined a "general power" as one "exercisable in favor of the donee, his estate or his creditors."[37] Notice even the New York case creating *by implication* a power that would be general and taxable under the Internal Revenue Code definition.[38] There may thus be pre-1942 powers as well as post-1942 powers in effect which cannot be changed and in some instances cannot be released which are caught by the present definition.

By embodying the exception of "ascertainable standard" for withdrawal or encroachment powers, the 1951 Act and 1954 Code show an intention that all other powers to "consume, invade or appropriate" are to be taxed. This is indeed a trap for the unwary.[39] Such powers are frequently employed by lawyers for reasons quite different from those dictating creation of general powers. Some may have been included in wills drafted pre-1942 when no such interpretation existed and even the "death before 1949" provision of Section 2041(b)(3) gives no relief. In the same connection it is of doubtful wisdom to include the highly uncertain area of "ascertainable standard"—an area in which Justice Frankfurter found it necessary to reverse his position remarking:

> Wisdom too often never comes and so one ought not to reject it merely because it comes late. Since I now realize that I should have joined the dissenters in the *Merchants National Bank of Boston* case, 320 U.S. 256, I shall not compound error by pushing that decision still farther.[40]

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36 McCoid, "The Non-General Power of Appointment—A Creature of the Power of Appointment Act of 1951," 7 Vand. L. Rev. 53 (1953).

37 See Morgan v. Commissioner, 309 U.S. 78 (1940), approving the regulation as found in U.S. Treas. Reg. 80, art. 24 (1937).

38 In re Clark, 274 App. Div. 49, 80 N.Y.S.2d 1 (1st Dep't 1948).

39 Allen, "Powers of Appointment and the Drafting of Missouri Wills," 1954 Wash. U.L.Q. 408, 417; S. Rep. No. 382, 82d Cong., 1st Sess. (1951). See also the enumeration of other situations deemed to qualify in U.S. Treas. Reg. 105, § 81.24(a)(2) (1939).

40 Hensler v. Union Planters Bank, 335 U.S. 595 (1949); cf. Merchants National Bank v. Commissioner, 320 U.S. 256 (1943) with Ithaca Trust Co. v. United States, 279 U.S. 151 (1929). See also U.S. Treas. Reg. 105, § 81.24(a)(3) (1939).

Without laboring the point, it may be mentioned that serious questions are left unanswered (a) by the "accountability" test which was eliminated from the statute but remained in the Committee report and regulations[41] —and the state tests of accountability are numerous and varied; (b) by the "adverse interest" test with its infinite variety of cases;[42] (c) by conflicts arising between states and between state and federal law as to exercise of powers in favor of creditors.[43]

It seems to the writer unwise to leave so many issues unresolved in a statute intended to clarify the law, particularly in so far as the newer non-property definition of "general power" is applied to powers drafted prior to the insertion of the definition.

Refusal of Appointee to Take Under Appointment and Election to Take in Default of Appointment—Is a Pre-1942 Power Then Subject to Tax?

As has been pointed out, the pre-1942 statute taxed property *"passing* under a general power of appointment *exercised* by the decedent." [Emphasis supplied]. In *Helvering v. Grinnell*,[44] the Supreme Court first faced the question whether a tax applied if the appointee refused the appointment and took in default of appointment. The court held that the tax did not apply. Its reasoning emphasized that the statute disclosed three requisites: a general power, exercise and passing of property. It hinged its decision on the conclusion that no property passed:

> Analysis of this clause discloses three distinct requisites—(1) the existence of a general power of appointment; (2) an exercise of that power by the decedent by will; and (3) the passing of the property in virtue of such exercise. Clearly, the general power existed and was exercised; and this is not disputed. But it is equally clear that *no property passed under the power* or as a result of its exercise since that result was *definitely rejected by the beneficiaries*. If they had wholly refused to take the property, it could not well be said that the property had passed under the power, for in that event it would not have passed at all. Can it properly be said that because the beneficiaries elected to take the property under a distinct and separate title, the property nevertheless passed under the power? Plainly enough, we think, the answer must be in the negative.[45] (emphasis supplied)

When Professor Griswold treated the earlier statutes and proposed the changes which became effective in 1942, he also discussed the problem

41 See Craven, note 25 at 70-71 op. cit. supra.

42 Int. Rev. Code of 1954, 2041(b)(1)(c); Craven, supra note 25 at 72-75.

43 See, for example, in New York, Cutting v. Cutting, 86 N.Y. 522 (1881); Farmers' Loan and Trust Co. v. Mortimer, 219 N.Y. 290, 114 N.E. 289 (1916); Whiteside, "Life Estates with Power to Consume: Rights of Creditors, Purchasers and Encumbrancers under Real Property Law Sections 149-153," 16 Cornell L.Q. 447 (1931).

44 294 U.S. 153 (1935).

45 Id. at 154.

under the headings of the power, the exercise and the passing.[46] He, however, questioned whether the *Lansing* case[47] relied on by the Court was decided on the basis of non-passing or non-exercise and in the second edition of his casebook again posed the issue.[48]

The 1942 Revenue Act made general powers taxable whether exercised or not. It therefore dropped both the language "exercised" and "passing," except to state that the new provisions did not apply "with respect to a power to appoint, created on or before the date of the enactment of this Act . . . unless such power is exercised. . . ."[49] Nothing was said at this time to distinguish the words "passing" and "exercise," but it would appear that "passing" is the only proper term to apply when describing "property" and "exercise" when referring to a "power." Since Section 403(d) made no mention of "property," the word "exercise" was correctly used in reference to the "power."

When the 1951 Powers of Appointment Act was adopted and an attempt was made to revert (or to almost revert) to the pre-1942 law, then the word "exercised" became a part of the operative portion of the statute and the word "passing" was not included. It is submitted that this was in accord with the structure of other portions of the Internal Revenue Code, Section 811: "The value of the gross estate [shall include] all property (without saying "passing") to the extent of (exercise)."[50] For the first time the Senate Finance Committee Report attempted to attach some consequence to the absence of the word "passing."[51]

After the 1942 Act but prior to the 1951 Act, however, the Supreme Court had seemed to express itself as seeing no difference between the concept of "passing" and "exercise" in *Estate of Rogers v. Commis-*

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46 Griswold, "Powers of Appointment and the Federal Estate Tax," 52 Harv. L. Rev. 929, 933-947 (1939).

47 Matter of Lansing, 182 N.Y. 238, 74 N.E. 882 (1905).

48 Does the case (Grinnell) necessarily involve a question of "passing"? How far may it be said that the power is not exercised unless it is effectively exercised? Compare the Rogers case, below, and see Paul, Federal Estate and Gift Taxation § 9.22 (Supplement 1946).

Griswold, Cases and Materials on Federal Taxation 237 (2d ed. 1946).

49 Revenue Act of 1942, § 403(d), 56 Stat. 944 (1942).

50 Int. Rev. Code of 1939, §§ 811(a)-(g).

51 Before the 1942 act only the exercise of a general power of appointment was taxable. . . . As to powers created before the 1942 act, the bill in substance restores the law as it existed prior to 1942 with one minor change, to eliminate the "passing" problem. . . . The former statute taxed property "passing" under a general power of appointment exercised by the decedent. This sometimes gave rise to litigation where the decedent appointed part or all of the property to persons who would also have taken it under the terms of the original instrument creating the power. The bill eliminates this possibility by taxing all property with respect to which the decedent has exercised" a general power of appointment.

With this exception, the intent of the bill is to restore the law regarding pre-existing powers as it existed prior to the 1942 act.

S. Rep. No. 382, 82d Cong., 1st Sess. 1530-32 (1951).

sioner.[52] In that case a widow, a daughter and a son would each have taken one-third of the property in the absence of appointment. The donee created distinctly different interests: 6.66% to the widow, the daughter and a grandson, of the balance 1/3 went absolutely to the grandson, 1/3 in trust for the widow and 1/3 in trust for the daughter, nothing to the son. Said the Court:

> . . . For the purpose of ascertaining the corpus on which an estate tax is to be assessed, what is decisive is what values were included in dispositions made by a decedent, values which but for such dispositions could not have existed. That other values, whether worth more or less as to some of the beneficiaries would have ripened into enjoyment if a testator had not exercised his privilege of transmitting property does not alter the fact that he and no one else did transmit property which it was his to do with as he willed. And that is precisely what the federal estate tax hits—an exercise of the privilege of directing the course of property after a man's death. . . .
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> Whether by a testamentary exercise of a general power of appointment property passed under § 302(f) is a question of federal law, once state law has made clear, as it has here, that the appointment had legal validity and brought into being new interests in property. . . . Congress used apt language to tax dispositions which came into being by the exercise of a testamentary privilege availed of by a decedent and which in no other way could have come into being. Such is the present case. To bring about the results which decedent sought to bring about, he had to deal with the whole of the corpus over which he had the power of disposition. To give what he wanted to give and to withhold what we wanted to withhold, Rogers, Jr. had to do what he did. And so what is taxed is what Rogers, Jr. gave not what Rogers, Sr. left. . . .
>
> Nothing that was decided or said in *Helvering v. Grinnell,* 294 U.S. 153, stands in the way of this conclusion. *Where a donee of a power merely echoes the limitations over upon default of appointment he may well be deemed not to have exercised his power, and therefore not to have passed any property under such a power.* . . .[53] (emphasis supplied)

Well, there is the background, men; choose your sides. Buck, Craven, Shackelford and Eisenstein[54] place themselves on the side of believing that the elimination of the word "passing" from the 1951 Act and the 1954 Code changes the *Grinnell* rule; Griswold and Paul[55] somewhat more cautiously doubt that it does. I place myself among the doubters—doubts which for me have come closer to certainty, as I shall show.

First: I have set forth earlier the general theory based on the consensual element in all transfers by which a devisee or appointee has the right to refuse the devise or appointment.[56]

52 320 U.S. 410 (1943).

53 Id. at 413-15.

54 See supra notes 17 and 22.

55 See supra note 48; Paul, Federal Estate and Gift Taxation 224-5 (1946 Supplement).

56 See supra notes 3-7. The Court of Appeals of New York in In re Wilson's Estate, 298 N.Y. 398, 83 N.E.2d 852 (1949) recognized the rule and reversed the surrogate and

Second: I have already suggested that the term "passing" relates to property and "exercised" relates to powers. "Passing" adds nothing to "exercised"; when a power is exercised property passes; when property passes it is by virtue of the exercise. This, it seems to me, is the meaning of the *Rogers* addendum to the *Grinnell* decision. So also does it seem to be the basis of the words in the later New York decision in *Rogers Estate*[57] and in *Matter of Lansing*[58] on which the Supreme Court relied in the *Grinnell* case. This accords with the Supreme Court's use of these terms in other cases.[59]

Third: Nor do the changes in statute or regulations show any clear distinction between "passing" and "exercised." The first regulation attempting to bring powers of appointment under the general estate tax provisions, rejected in the *Field* case, used the term "exercise" and assumed that exercise caused property to pass:

> When a decedent exercises a general power of appointment as donee under the will of a prior decedent the property *so* passing is a part of the gross estate of the decedent appointor.[60] [Emphasis supplied].

In 1918 the House proposed to tax powers of appointment, using the words now familiar—"any property passing under a general power of appointment exercised by the decedent." The Senate attempted to change this into an inheritance tax on "transfers . . . including . . . the exer-

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Appellate Division only in finding that the facts showed an acceptance. The summary of the rule stated by Surrogate Griffiths with a wealth of authority is as follows:

> It is well settled that a bequest or devise is in the nature of an offer by the testator to the legatee or devisee of the subject matter of the gift, which he may accept or reject. (Citing cases). . . . That a person has an absolute legal right to accept or reject a legacy or devise is well established by the authorities both in this and other states. (Citing cases). . . . An effective renunciation of a testamentary gift irrevocably nullifies the right of acceptance and the result is the same as though the will contained no provision for such gift.

68 N.Y.S.2d 482, 484-5 (Surr. Ct. Westchester County 1946).

An argument can be made that as to appointments in favor of takers by default the power is "special," and pre- or post-1942, cannot be taxed. Pre-1942 joint powers are not general and post-1942 powers are not if the other party has a substantial adverse interest [§ 2041(b)]. "A taker in default of appointment has an interest which is adverse to such an exercise." S. Rep. No. 382, 82d Cong., 1st Sess. 1534 (1951).

57 Nor need we consider what the situation would have been if there was an exact equivalence between the amount which the beneficiaries received by the power and in default of its exercise . . . (on the theory that) the donee, in fact, did not exercise the power. . . .

In re Rogers Estate, 269 App. Div. 551, 557, 56 N.Y.S.2d 289, 295 (2d Dep't 1945), aff'd, 296 N.Y. 676, 70 N.E.2d 170 (1946).

58 Although the power was exercised in form, her title was perfect without it and she derived no benefit from it. . . . The exercise of a power which leaves everything as it was before is a mere form with no substance.

Matter of Lansing, 182 N.Y. 238, 243, 74 N.E. 882, 884 (1905).

59 Helvering v. Safe Deposit and Trust Co., 316 U.S. 56 (1942); United States v. Field, 255 U.S. 257 (1921).

60 T.D. 2477, 19 Treas. Dec. Int. Rev. 84 (1917).

cise by will of general powers of appointment" (word "passing" not used). In conference the House language was restored. There is nothing in the reports to show a belief that "passing" added anything to "exercise," in fact "passing," "transfer" and "exercise" were apparently used interchangeably.[61]

Fourth: There is no consistency within the present Internal Revenue Code to demonstrate that "passing" is a different concept from "exercise" or that disclaimer by takers in default is not permitted. Thus Section 1014(b) fixing the base of property uses the pre-1951 terminology: "property *passing* . . . under a general power of appointment exercised by the decedent by will." [Emphasis supplied]. The word "passing" is extensively used, as in Section 2056 dealing with marital deductions and in particular in the "heads I win—tails you lose" provisions of 2056(d) recognizing disclaimers by devisees and appointees. Section 2055 expressly authorizes disclaimers of bequests and powers in favor of charitable takers by default and recognizes that this qualifies for the charitable deduction. Section 2205 provides that if a part of the estate "passing" to any person pays a tax that person may have reimbursement from the estate; "passing" here seems descriptive of what happens on "exercise" of a power of appointment. Section 2207 is also meaningless unless "exercise" and "receive" (or "pass") are considered but two sides of the same coin. That section provides "if any part of the gross estate on which the tax has been paid consists of the value of property included in the gross estate under Section 2041, the executor shall be entitled to recover (the tax paid) from the person *receiving* such property by reason of the exercise, nonexercise, or release of a power of appointment." [Emphasis supplied]. But if there is an "exercise" even though the appointee renounces and refuses to take or "receive" and it is asserted that a tax is thereby incurred, will the executor then be unable to recover from the appointee since the appointee has not "received" any property under the *Grinnell* rule? In the gift tax law, Section 2514 of the 1954 Code relating to powers of appointment, is found the statement: "An exercise of a general power of appointment created on or before October 21, 1942 shall be deemed a transfer (passing) of property." Now this either states the truism that effective exercise transfers property or it is an attempt to create a conclusive presumption contrary to the facts, condemned in *Heiner v. Donnan*.[62]

Fifth: The cases which have stated that the elimination of the word

[61] H.R. Rep. No. 767, 65th Cong., 2d Sess. 21-2 (1918); S. Rep. No. 617, 65th Cong., 3rd Sess. 15, 41-2 (1918); H.R. Rep. No. 1037, 65th Cong., 3d Sess. 25-30, 70-71 (1918).

[62] 285 U.S. 312 (1932).

"passing" since 1942 effects a change in the *Grinnell* rule and *Rogers* addendum cannot be considered authoritative. In each the interest created by the exercise was different from what the takers by default would receive under the original will.[63] They therefore represent *Rogers* type cases. On the other hand wherever there has been an appointment only to those who would take in default and of the same shares and interests, the *Grinnell* rule has been applied both pre and post-1942.[64] This is also the view of the New York courts under statutes, similar to the post-1942 federal revenue acts, requiring only "exercise" and not "passing."[65] Both

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[63] Estate of Sarah V. Moran, 16 T.C. 814 (1951). In this case there was a common exercise of a reserved and of a donated power. The reasoning is dictum since the court recognizes that "Here the interests created by the decedent's exercise of her power of appointment were not the same as those which would have existed in default of appointment." See also Wilson v. Kraemer, 190 F.2d 341, 344 (2d Cir. 1951) cert. denied 342 U.S. 859 (1951), where it was stated:

> . . . the appointment here was not of an echoing kind. For the decedent exercised the power to make five money bequests, aggregating $21,501.00, to individuals not mentioned by his mother, and, of the property subject to the power gave only the balance to the daughter, who would have taken in default of appointment.

In Guaranty Trust Co. of New York v. Johnson, 165 F.2d 298, 300 (2d Cir. 1948) the appointment was of the appointive property and the decedent's property in common through the residuary estate. The appointee would have to attempt to "partially" renounce or lose other property:

> What she did was no mere echo of terms of deed of trust. She . . . exercised her power to enhance her own estate at the moment she died and thereby blended together all the property she controlled.

See also Kerr v. Commissioner, 9 T.C. 359 (1947), aff'd, 174 F.2d 555 (3rd Cir. 1949) where different interests were created.

[64] Commissioner v. Cardeza's Estate, 5 T.C. 202 (1945), aff'd, 173 F.2d 19 (3rd Cir. 1949); Estate of Mabel Wooster, 9 T.C. 742 (1947); Estate of Shepherd, 32 B.T.A. 208 (1935).

> [65] Not every exercise of a power has been held taxable to the estate of the donee, as where the appointment is identical in amount and to persons who would have taken in default of exercise of the power (Matter of Lansing, 182 N.Y. 238; Matter of Backhouse, 110 App. Div. 737; aff'd, 185 N.Y. 544; Helvering v. Grinnell, 294 U.S. 153) or where a beneficiary receives less than he would have taken in default of the exercise. (Matter of Slosson, 216 N.Y. 79).

Matter of Duryea, 277 N.Y. 310, 316, 14 N.E.2d 369, 370 (1938).

> We need not consider what the situation would have been if the beneficiary had expressly renounced all rights to take under the will (of the donee). In such a case there can be no "passing" of property under the power . . . , and hence the property could not be taxed as part of the donee's estate. Nor need we consider what the situation would have been if there were an exact equivalence between the amount which the beneficiaries receive by the power and in default of its exercise. In the latter case it has been held that the beneficiary takes under the donor's will. This conclusion is reached on the theory that . . . the donee, in fact, did not exercise the power and no property passed thereunder, since the result is exactly the same as if there had been no exercise of the power. (Emphasis supplied.)

In re Roger's Estate, 269 App. Div. 551, 557, 56 N.Y.S.2d 289, 295 (2d Dep't 1945), aff'd, 296 N.Y. 676, 70 N.E.2d 179 (1946).

> It has long been settled in this State that where the exercise of a general testamentary power of appointment transfers no more to the beneficiary than he would have received in default of such exercise under the instrument creating the power the property is deemed for purposes of death taxation to have passed under the latter instrument and is therefore not taxable in the estate of the donee.

the *Grinnell* and *Rogers* cases recognized that whether there had been an effective exercise was a question of state law. If, as seen from the cases, New York views an "exercise" in the exact shares to the takers by default, particularly in case of disclaimer, as an ineffective exercise it would seem no more subject to federal tax than any other ineffective exercises.[66] Certainly it would not be claimed that where a donee "exercised" his power of appointment in a will with only one witness (in a state where two are required) that there was a taxable exercise. In a most recent Revenue Ruling it has been held that where the creation of a trust by the donee of a power and the two remaindermen "did not increase or decrease his (donee's) own interest or increase or decrease or alter in any way the interests of the contingent remaindermen" (takers in default) the donee has not "exercised" a pre-1942 general power of appointment under I.R.C. 811(f)(1)—the 1951 Powers of Appointment Act.[67]

It is also believed that the *Moran, Kraemer* and *Johnson* cases[68] relied too heavily on Regnlation 105, Section 81.24, which was said to have "the effect of law" since Section 403(d)(3) embodying the word "exercised" had been re-enacted after the adoption of this regulation. While it is true that no similar provisions appeared in the regulations from 1934 to 1942, similar provisions did exist since 1919[69] and were in effect at the times involved in the *Grinnell* and *Rogers* cases.

Perhaps we need to pay more attention (a) to the distinction between "reserved" powers, where the Supreme Court has recognized the right to

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Estate of Rogers v. Tax Commission, 296 N.Y. 676, 678, 70 N.E.2d 170, 171 (1946).

> The execution of the power left the title where it was before, and the result is the same as if there had been no power to exercise. . . . Although the power was exercised in form, her title was perfect without it and she derived no benefit from it. . . . The exercise of a power which leaves everything as it was before is a mere form, with no substance.

Matter of Lansing, 182 N.Y. 238, 243, 74 N.E. 882, 883-4 (1905). See also In re Sandford's Estate, 277 N.Y. 323, 14 N.E.2d 374 (1938); In re Larkins' Will, 183 Misc. 1052, 50 N.Y.S.2d 500 (Surr. Ct. Suffolk County 1944).

66 Estate of Edith Wilson Paul, 16 T.C. 743 (1951) (violating the Pennsylvania rule against perpetuities); Reginald Fritz, P-H 1945 T.C. Mem. Dec. ¶ 45,327 (conditioned on an inadequate estate and thereafter to avoid federal taxes two legatees renounced); Estate of Dancer, 30 B.T.A. 1277 (1934) (not exercised as required by the trust instrument).

67 Rev. Rul. 54-271; 1954 Int. Rev. Bull. No. 28.

68 See supra note 62.

69 U.S. Treas. Reg. 105, Section 81.24 (1939) reads:

> . . . A power to appoint is exercised where the property subject thereto is appointed to the taker in default of appointment regardless of whether or not the appointed interest and the interest in default of appointment are identical, and regardless of whether or not the appointees renounce any right to take under the appointment.

U.S. Treas. Reg. 37, Art. 30 (1919 ed.); (1921 ed.); U.S. Treas. Reg. 63, Art. 25 (1924); U.S. Treas. Reg. 68, Art. 24 (1926), all provided:

> Property appointed under a general power should be included in the estate of the appointor, although the persons to whom the appointment was made would have taken the property had not the power been exercised.

tax the ability to shift enjoyment[70] and "donated" powers, particularly if we are going to tax a second time property going to those designated by the original decedent (donor) for in the latter case the donee *never* had property over which he retains some control,[71] and (b) to the constitutional issue of retroactively taxing property passing pursuant to pre-1942 wills to takers in default merely because a donee "exercised" a power without in any way affecting the interest of the takers in default.[72]

Nor must we forget that in the Circuit Court opinion in the *Rogers* case[73] all the judges agreed that an exercise of a power and renunciation prevented the tax from applying, and Hand, J. developed very cogent reasons for following the New York cases where exactly the same shares were appointed as the takers in default would receive and there was no renunciation.[74]

Sixth: From the beginning there has been a close analogy between the right of the government to tax the donee of a general power and the rights of creditors of the donee to reach assets over which he has a general power. This was the argument strongly urged by the government and discussed by the Supreme Court at length in the attempt to reach powers of appointment in the *Field* case.[75] The great weight of authority is that creditors cannot reach property over which their debtor has a general power of appointment so long as he does not exercise it; if he exercises it in favor of volunteers, creditors may reach the assets; but creditors cannot reach the assets in the hands of the takers by default.[76] A similar rule has

70 Porter v. Commissioner, 288 U.S. 436 (1933).

71 Angell, "The Impact of the Law of Powers upon Our Internal Revenue Laws," 39 Mich. L. Rev. 1269, 1270 (1944).

72 Matter of Lansing, 182 N.Y. 238, 74 N.E. 882 (1905).

73 Commissioner v. Roger's Estate, 135 F.2d 35 (2d Cir., 1943).

74 I am not prepared to say that where the appointee does not renounce, the interests appointed must inevitably pass under the power. There is something to be said practically for the contrary, once we refuse to accept the rule that any exercise of the power is irrelevant. Certainly no donee would ever exercise a power in favor of a legatee in default if he knew that its only effect would be to include the property within his taxable estate. Nor does it seem quite fair to put it into the appointee's hands by accepting, instead of renouncing, an appointment which makes no difference to him, to throw the tax upon the donee's estate. On less provocation, courts have often avoided such harsh results by holding that the intent of the testator was not correctly expressed in his words.

Id. at 39.

75 United States v. Field, 255 U.S. 257 (1921).

76 Annot., 59 A.L.R. 1510 (1929); 97 A.L.R. 1071 (1935); 121 A.L.R. 803 (1939); Clapp v. Ingrham, 126 Mass. 200 (1879); Restatement, Property, §§ 327-331, 451-53 (1936). See also In re Peck's Estate, 320 Mich. 692, 32 N.W.2d 14 (1948); 5 Am. Law Property § 23.19ff (Casner ed., 1952). The right of creditors is even more limited in New York by statute and decision: N.Y. Real Prop. Law §§ 149-153, 159; Cutting v. Cutting, 86 N.Y. 522 (1881); Farmers Loan and Trust Co. v. Kip, 192 N.Y. 266, 85 N.E. 59 (1908); Farmers Loan and Trust Co. v. Mortimer, 219 N.Y. 290, 114 N.E. 389 (1916); Whiteside, "Rights of Creditors in New York," 16 Cornell L.Q. 447 (1931).

always been applied in New York in computing tax rates—that the renouncement of a legacy is as though no legacy were created.[77] And at least one federal court has recognized that the right of the government to collect a tax on renunciation by an appointee is even less clear than that of a pre-existing creditor, for it has no prior rights and its tax claim grows out of the very transaction renounced.[78]

Seventh: Finally, policy reasons would seem to encourage the retention of the *Grinnell* rule. The whole theory of taxing only general powers of appointment is that the donee has the equivalent of ownership. The persons in favor of whom a power of appointment is usually employed are the near relatives of the original decedent. If they were designated, as a class in whose favor the power could be appointed, the power would be non-general and not taxed. Similarly, as to pre-1942 powers if the donee took no action the property would go to the takers in default free of a second tax. It must be recalled that the property has already borne one tax in the estate of the donor and it is doubtful whether the donee's relationship to the property has been extensive enough to warrant a second tax where the property in fact goes under the donor's will without the donee having affected it one iota. It is doubtful whether a donee should be said to exercise a power where the *only* effect is to impose a second tax. If there is any one case in which a power of appointment should not give rise to a tax it would seem to be where the persons designated by the donor do in fact take from the donor and not from the donee. This would seem at least as clear as to exempt the release of a pre-1942 power tax free,[79] for the donee has complete control up until release—which may occur one minute before death. Further, IRC Section 2041 itself recognizes a distinction between "disclaimer" and "renunciation" on the one hand, where the theory is that the item disclaimed never comes into existence, and "release" where the power takes effect and is subsequently given up.[80] And finally, is there any greater reason for retaining the pre-1942 rule that "joint" powers are not general powers[81] than for retaining the *Grinnell-Rogers* view?

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77 Matter of Wolfe, 89 App. Div. 349, 85 N.Y. Supp. 949 (2d Dep't 1903), aff'd, 179 N.Y. 599, 72 N.E. 1152 (1904); Merritt's Estate, 155 App. Div. 228, 140 N.Y. Supp. 13 (1st Dep't 1913); In re Bushnell's Estate, 73 App. Div. 325, 77 N.Y. Supp. 4 (1st Dep't 1902), aff'd, 172 N.Y. 649, 65 N.E. 1115 (1902).

78 Brown v. Routzahn, 63 F.2d 914, 917 (6th Cir. 1933).

79 Int. Rev. Code of 1954, § 2041(a)(1); U.S. Treas. Reg. 105, § 81.24 (1939); U.S. Treas. Reg. 108, § 86.20 (1939).

80 Int. Rev. Code of 1954, § 2041(a)(2).

81 Id., § 2041(b)(1)(B).

CONCLUSION

For a statute which was "to make the law simple and definite enough to be understood and applied by the average lawyer," the provisions of the 1954 Internal Revenue Code as to pre-1942 powers of appointment leave much to be desired. I would suggest in the interest of simplicity, yes—but of fairness, even more—that at least these changes be made: (1) pre-1942 powers should include those in any will executed pre-1942 regardless of when the donor dies; (2) the definition of "general" or "taxable" powers should be further clarified and "recondite niceties" should be eliminated; (3) where the donee attempts to appoint to the takers in default exactly as they would receive the property as such takers, no tax on the power of appointment shall be collected whether there is a renunciation or not.